DOW THEORY LETTERS INC.

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Feb. 6, DJIA 954.90; PTI 496; A-D ratio - 23.28
Feb. 13, DJIA 958.36; PTI 511; A-D ratio - 22.65

THE MARKET: A subtle change seems to have crept into the market. Study the chart on page 2. Note that the July-September, 1975 slump in the advance-decline ratio was considerably worse than the comparable drop in the D-J Industrial Average. The ensuing rally to the early December peak took the Dow to within 20 points of its mid-1975 high (881.81 on the Dow). But the September-December rally in the A-D ratio was decidedly sluggish, indicating that the great mass of stocks on the NYSE were reluctant to follow the lead of the D-J Industrial Average.

The final drop to the December 9, 1975 low took the A-D ratio to within 1 point of its September low (at which level the A-D had wiped out almost all of its gains for 1975). But on the same day (December 9), the Dow was still better than 200 points above its January 1 level. Thus the Dow was showing far greater strength than the A-D ratio. Thereafter, the character of the market began to change.

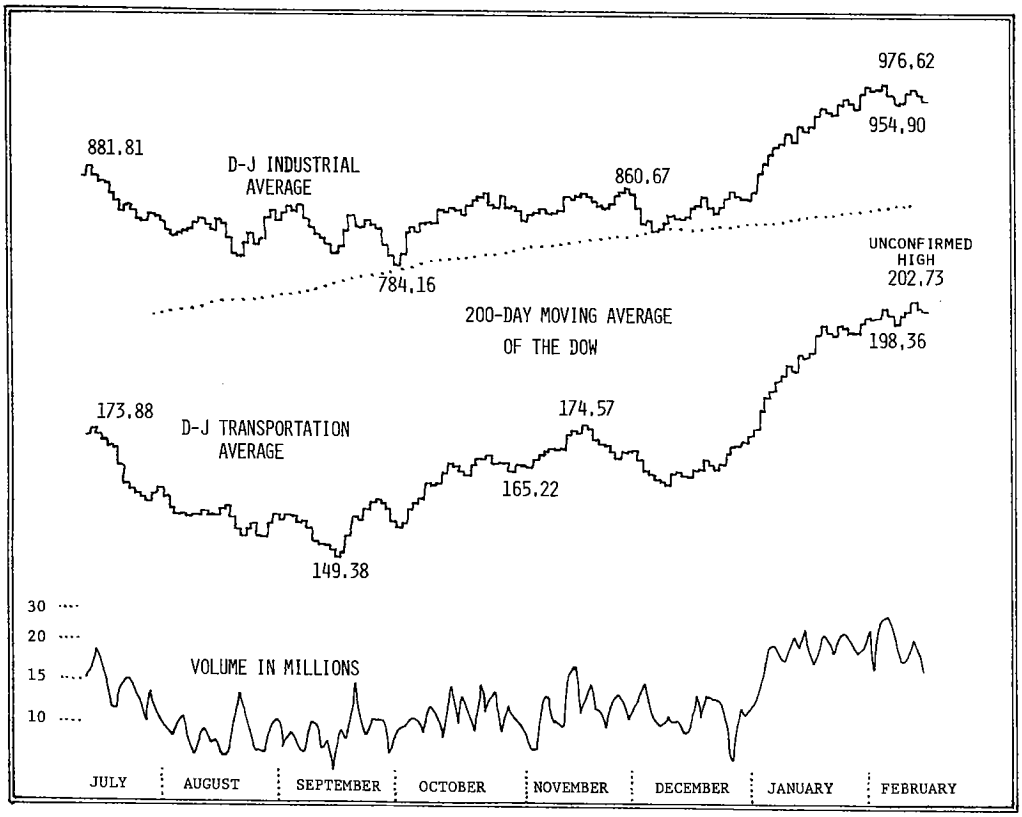
A "buying stampede" started from the December 9 lows. The buying stampede marked the beginning of the period in which the general market, as measured by the A-D ratio, began to outperform the Dow. Note the series of jagged little declines in the Dow during the January and February advance. Now compare this action with the almost straight-line advance in the A-D ratio during the same period. The persistence and sheer power of the A-D advance since December 9 has been, to say the least, extraordinary.

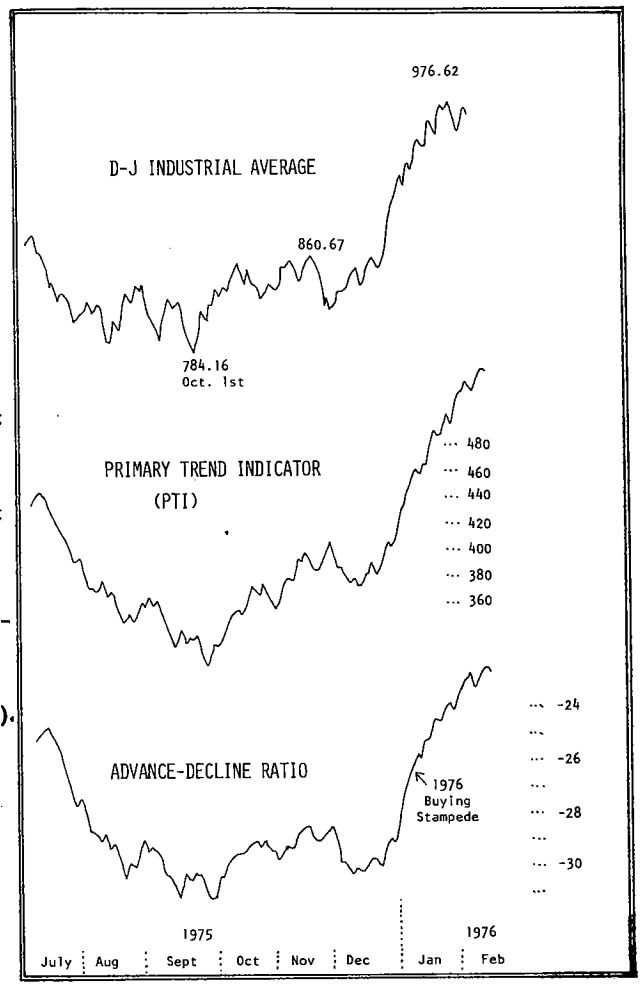
I define a buying stampede as any rise of 5 points or more in the A-D ratio without an intervening 1 point correction. Since the rise since December 9 has lifted the A-D ratio almost 8 points as of this writing, it is clear that we are still very much in the buying stampede phase. Furthermore, we are very close to passing the explosive 8.80 point rise of the A-D ratio which occurred during December, 1974 to March, 1975. That comparison should give readers some idea of the power of the current rise.

Of interest is the fact that on February 11th the A-D ratio, following a mild dip (see chart), rallied to a new bull market recovery high. The Dow on the same day was still 10 points below its own February 4 peak. For the first time in 1976, the general market (as gauged by the A-D ratio) was forging ahead of the Dow.

In my opinion, the extra, added strength in the A-D ratio is a result of the spreading recognition that a great portion of the NYSE is now undervalued compared with the Dow. As I stated in the last Letter, as of January 23, 1976, 44% of all NYSE issues were still selling under $10. In a February 6, 1976 report, Value Line published a list of 15 rather typical "secondary stocks" showing that these issues (as of the end of January, 1976) were earning an average of 20% more than they were at their previous bull market highs. Yet as of the end of January, 1976, these stocks (on average) were still selling 82% below their bull market highs!

I have further discussed this remarkable situation in the section of this report entitled "Relative Strength in the Averages" and in the section which lists stock declines from their bull market highs and subsequent recoveries. It is the recognition of this phenomenon (i.e., the fact that there is still so much undervaluation in this bull market) that is lending strength to the A-D ratio. Remember, during the second phase of a bull market (and we are there now) stocks advance as they reflect improving conditions for corporate profits. The fact is that a huge mass of stocks on the NYSE (to say nothing of the other exchanges) are still selling at levels which reflect the expectation of depression, not the improving business that this primary bull market has forecast.





NEAR-TERM: The D-J Industrial and Transportation Averages recorded joint highs for this bull market on February 4, Industrials at 976.62, Transports at 201.25. A decline followed, but six trading days later (February 11) the Transportation Average pushed to a new bull market high of 202.73. The Industrials did not confirm the new Transport high.

Following this little non-confirmation, the market turned irregular with both Averages trending lower. The first near-by decline points of any significance are the February 6 Transport low of 954.90 for Industrials, 198.36 for Transports. A joint breaking of those points would mean that the minor trend of the market had turned down. That would be the first hint of a possible secondary correction in the offing. BUT a refusal of one or both Averages to break those lows on any continued weakness from here would indicate great strength for this market (particularly in view of the large advance which has occurred so far in 1976).

Despite the irregularity (or should we say potential trouble) in the Averages, the A-D ratio and the Primary Trend Index (see page 2 chart) both pushed into new high ground for this bull market as late as February 12 (six trading days after the last confirmed highs in the Averages). This phenomenon in the past has been evidence of a strong market, and it is action that should not be glossed over lightly. The Primary Trend Index (PTI) measures the daily plurality of eight critical technical indicators, and a new high in this index implies continuing technical strength.

By the same token, the new high in the A-D ratio suggests that the general "market" is resisting the downside, despite the obviously overbought situation of the Averages. The struggle now appears to be one of whether the powerful action of the A-D ratio and the PTI can hold any correction in the Averages to a minimum. Again, I will add that it is good policy to give a primary bull market every benefit of the doubt. If this market is going down, it is going there grudgingly. Strong bull markets often produce sideways lines in lieu of downward corrections, and we could be getting a taste of that kind of action now.

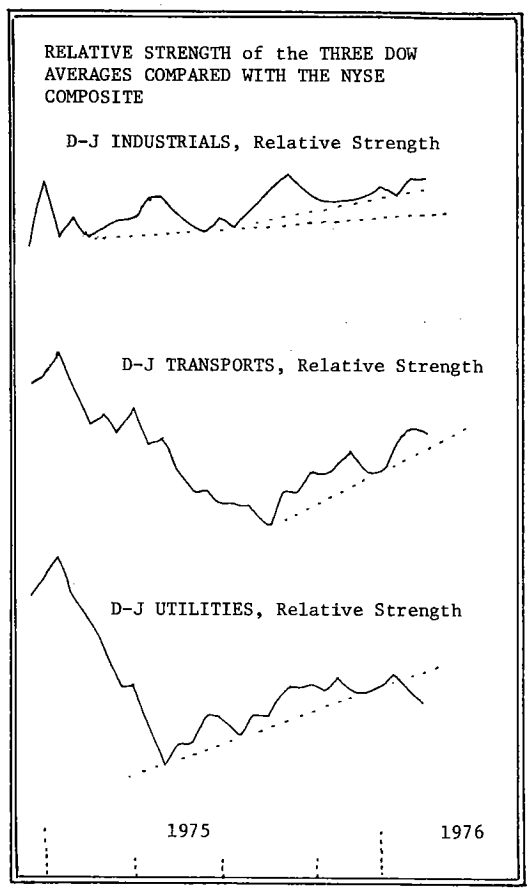
TOO MANY BULLS? From every quarter we hear that "there is too much bullishness around, and all the advisory services are bullish." Bullishness or bearishness is always a relative concept. The great Dow Theorist, Robert Rhea, wrestled with the same problem back in the 1930's when he asked the question, "How hot is hot?"

It should be remembered that bullishness during a bull market, and optimism during a bear market rally are two different "animals." Every bull swing in a primary bull market in time develops a feeling of hopefulness. But there are times in a bull market when all the optimists are right, at least for awhile. The reason is because the bulls have the primary trend working for them during a bull market, and a powerful bull swing just doesn't end with mild bullishness, it ends in almost frenzied optimism.

On the other hand, too much bullishness in a bear market rally will quickly put an end to the uptrend, as those who lived through 1973 and 1974 well remember. Every bouncing little rally during 1973-74 brought in its contingent of hopeful traders, and each time the traders were dutifully wiped out (as eager sellers flooded the market with stocks they wanted to sell).

So just as all the bulls of 1973 and 1974 were wrong time after time, it seems that all the bulls of 1975 and 1976 are going to be right time after time. After all, it's been a long time since the dyed-in-the-wool bulls (or the "perpetual bulls," as Wall Street calls them) have been correct for any extended period of time. Last year and this year would seem to be the years when the all-out bulls may be righter than the cautious bulls (and one hell of a lot righter than the skeptics or the bears).

I have often warned subscribers about the "in" or fashionable indicator. This year the indicator the advisories have all learned to love is the bullish-bearish count of the advisory services. Every service I read states that "there are far too many bullish advisory services," and therefore the end is in sight for this primary advance. This may be true, but I personally am wary of the publicity that the bullish-bearish advisory count is currently receiving. The unanimous "bullishness" of the advisories may be telling us something, but too many publications are watching the same picture for my money. Therefore, I now give less credence to this indicator than I have at any time since I started watching it.


RELATIVE STRENGTH of the THREE DOW AVERAGES COMPARED WITH THE NYSE COMPOSITE
D-J INDUSTRIALS, Relative Strength
D-J TRANSPORTS, Relative Strength
D-J UTILITIES, Relative Strength
1975
1976

RELATIVE STRENGTH IN THE AVERAGES: This is a study which I used many years ago, and thanks to Ian McAvity's Deliberations (PO Box 182, Adelaide St. Station , Toronto, CANADA M5C 2J1) I have been reminded of the importance of this approach again.

I have run the three Dow Averages as ratios of the NYSE Composite Index (charts show price of the Dow Averages divided by the NYSE Comp. on a beginning and middle of the month basis). The period shown is the bull market which began in December 1974.

What we see here is a rotation of strength. Remember, these are not prices, these are relative strength (RS) lines which indicate whether the Dow Averages are performing better or worse than the NYSE Composite. It is also well to remember that even though RS may be declining, the actual price of an average may be rising. So from that standpoint it might be best to view these RS lines as "money flow indicators," or indicators which show us (during a primary bull market) where the money is going at any given time.

Note that the Dow Industrial Average has been acting better than the general market (as measured by the NYSE Composite) ever since the bull market began. Starting in mid-1975, the rate of positive RS improved for the Industrials, and this is shown by the second steeper rising trendline.

Meanwhile, RS in the Transportation Average was rising gradually, but for the first two quarters of 1975 the Transport RS suddenly picked up strength, and since that time Transports have been the leader in RS of the three Dow Averages.

The Utility Average, held back by financing problems and the problem of liquidity, performed much worse than the general market during the early part of the bull market. During the second quarter of 1975, however, RS in the Utilities turned up dramatically, and the sterling performance of the Utilities lasted into 1976. Over the past month the Utility RS has turned down, breaking its rising RS trendline. This means that the Utilities are due to digest some of their huge 1975 gains. Or it could mean that investors see a turn in the favorable trend of interest rates, a turn that will affect the Utilities adversely.

The question arises, what would it mean if all three Dow Averages registered declining trends in their RS lines? This could easily happen, and if so it would mean that the general market is acting better than the Dow Averages. I expect this to occur some time during the current second phase of the bull market (that event may be in the making now), and it would mean that the big money flow is going into the run-of-the-mill stocks and the undervalued issues. In other words, it would mean that the money would be moving into the average issues rather than the higher grade issues as represented by the Dow Industrials and the Utilities. The Transports, which have exploded over the past few months, may also be due to rest while RS moves over to the "ordinary" issues which make up the great bulk of the NYSE Composite.

Conclusion: My studies of RS trends in the Averages indicate that these trends usually last six months to a year, seldom longer. The rising RS trends in the three Averages have continued to the point where I would expect all three shortly to turn down (Utilities already have). This is not necessarily bearish in a bull market. It simply means that the average stock on the NYSE is about to catch up with the Averages.

A "catch up" by the rest of the market would also be in line with the studies of the Value Line Composite Average (which is representative of the general market). So far, Value Line's unweighted Composite Average has recovered only 24% of its 1968-74 losses, a far cry from the recoveries seen in the D-J common stock Averages.

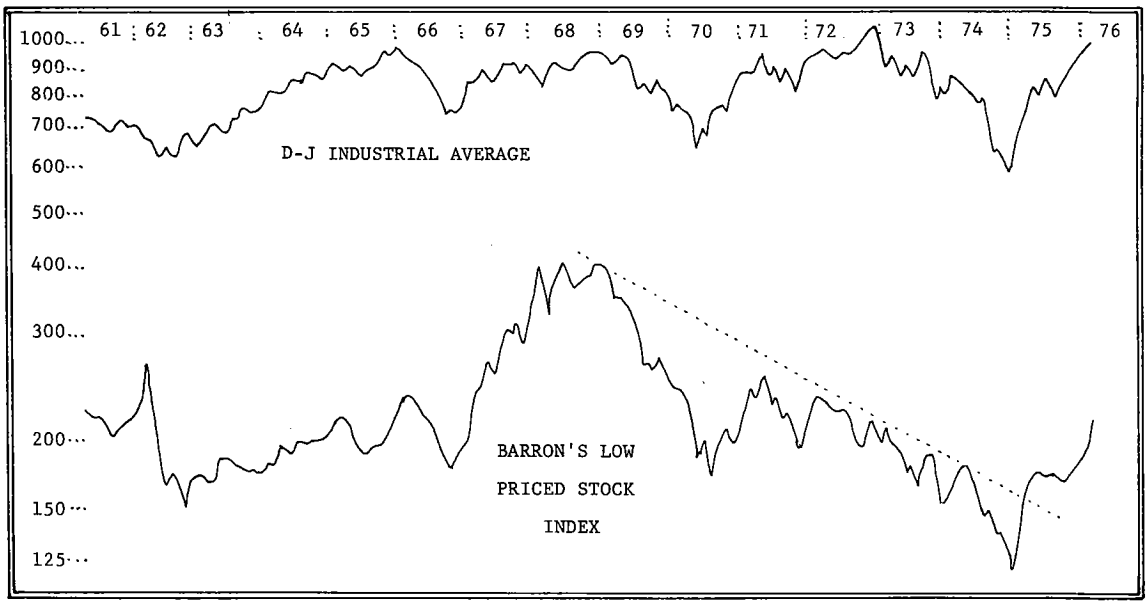
LOW-PRICED STOCKS: The "traditional" low-priced stocks (often referred to as the "cats-and-dogs" of Wall Street) should not be confused with many stocks that happen to sell in the lower price range at this time. The fact is that a huge portion of the stock market is still suffering from the crushing effects of the 1966-74 bear market, and many of these issues are still anywhere from 60% to 90% below their previous bull market highs. For instance, such stocks as Westinghouse, McGraw-Hill, Dillingham, Filtrol, and Addressograph are currently selling in the low price range, but these are not low priced stocks in the classical sense.

The true "cat-and-dog" issue is one that is subject to pronounced cyclical swing, running up during the late stages of a bull market and collapsing during the early phases of a bear market. Both Barron's and Standard &Poor's keep low-priced stock averages. These averages are purposely composed of stocks that are characterized by violent cyclical swings. The typical low-priced issue may start at 3 during the early stages of a bull market, move up to perhaps 9 during the end of the second phase, then spurt to 30 during the final phase of a bull market. During the first phase of the ensuing bear market this issue drops to 15. By the time the bear market is over, the stock is back to 3 again. Interestingly enough, this kind of issue seems to survive cycle after cycle. It's stubborn ability to survive, and its persistent tendency to run up and then slump back to the low range should probably earn it

the title of "perpetual swinger."

The following are examples of stocks which are actually in Barron's L-P Stock Average: Cooper Tire, Libby McNeill and Libby, Garlock, International Mining. Here are some stocks that are in S&P's L-P Average: Allis Chalmers, American Motors, Apeco, Atlas, Avnet, Thiokol, Welbilt.

I am including a chart showing the action of the D-J Industrials and Barron's L-P Stock index over a 16 year period. The chart is drawn to semi-logarithmic (often called ratio) scale. Thus the chart deals with percentages of movement. It is immediately evident that the swing in the L-P stocks are far greater on both the advance and the decline than are the swings in the Dow.



I want to draw attention to the fact, however, that most of the advance in the L-P Stock Average during the 1960's came during a two-year period of intense speculation. Those two years were 1967 and 1968, years which saw the L-P Average better than double in its wild ride to the 1968 peak of 413. During the next two years the L-P Average collapsed, wiping out all the 1967 and '68 gains and more. A little rally carried into 1971, and a further smash took the L-P Stock Average in late 1974 to its lowest level since the 1950's. During the entire 1968-74 decline, the Dow Industrials lost 45% of its value while the L-P Stock Average lost 73% of its value.

Now note the recoveries in both Averages during the bull market which started in December, 1974. As of this writing, the Dow has recovered 84% of its bear market losses while the L-P Average has recovered only 34% of its own bear market losses.

What can we infer from these figures? As I see it, we are currently in a primary bull market, and before it is over we should see a major rise in the L-P Stock Averages and the kind of stocks represented by those Averages. So far, we have had a recovery in L-P stocks but hardly an explosion. The kind of eventual explosion I am talking about could easily take Barron's L-P Stock Averageover its old 1968 high of 413. When will this occur? In the third or final phase of the bull market (we are still in the early part of the second phase).

But we have another important consideration at this time. As of January 23, 1976, a whopping 44% of all the stocks on the NYSE were selling below $10 (vs. 5.4% at the 1968 high). That extraordinary figure of 44% was a result of the great bear market decline of the late-1960's and early-1970's, the worst decline since 1937. The huge mass of under-$10 stocks are not the typical low priced issues of the kind which make up the L-P Averages. The bulk of the current under-$10 stocks are, in reality, fair to good quality stocks that have not yet recovered from the bear market.

For this reason, I feel that these stocks (I listed many of them in recent Letters) could show even greater recovery ability than the recoveries we might expect from typical low-price issues.

STOCKS: The corrective action of the market over the past week or so has hit (as I expected it would) the higher quality stocks, the stocks which have, so far, "carried the ball" in this bull market. But at the same time there has been a fascinating and unmistakable movement of funds into the lower priced and undervalued issues, the kind that I have been recommending in the last three reports. So pronounced has this trend been, in fact, that even while the Dow Averages were working lower, many of the lower priced issues have been moving to new highs for this bull market.

Does this mean that subscribers who own IBM or General Motors should immediately switch out of those issues and into Fedders or SCM? Not at all. It means that bull market money is moving back and forth over the list, combing out the undervalued situations, zeroing in on stocks which are improving their fundamental position but which have not yet advanced in price.

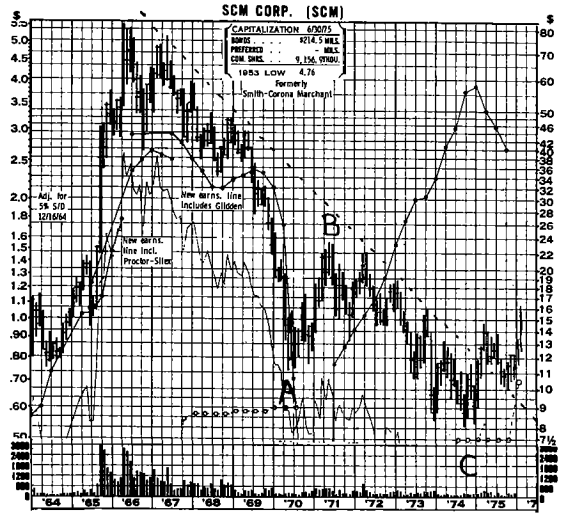
Among the groups which are now showing bullish relative strength (RS) charts are Auto Parts, Air Conditioning, Paper Containers, the major Electric Companies, Office Equipment, and Paper. Particularly poor RS trends are now being shown in the Food Chain group and Retail Mail Order. I cannot emphasize enough the importance of confining most of one's new commitments to stocks in groups showing bullish RS trends. As I have said so many times before, whatever economic trends help a given group, those same trends tend to help all the stocks in that group. Or to put it more bluntly, when investment money likes a certain stock group, it usually moves into all the stocks in that group. The exact converse may be said regarding declining RS in a group.

In the Auto Group I like Monroe (already recommended), a stock which sold as high as 48 in 1972. Budd Co. could be an interesting purchase (this company has just increased its quarterly dividend to 20¢ from 15¢. In Air Conditioning I have recommended Fedders, still a very low-priced number (it sold for 50 in 1971). I continue to recommend Fedders. In Paper Containers I like Rexham on the NYSE. The stock is a recent spin-off from Riegel Paper and sells in the $6 range. In the Electric-Electronic group I see two interesting speculations, Westinghouse and Litton. The former should work out its uranium contracts (with a lot of luck) and Litton could stage a comeback. Litton still sells 90% under its old high of just under $100.

In the Office Equipment group I recommended Addressograph, and I'll add SCM (particularly if you can get SCM on a pull-back towards the 15 level. SCM, down from a 1966 high of over $80, has now reversed an 8 year declining trendline, and my thought is that the stock is also reversing its basic position in its industry. This stock has just increased its quarterly dividend from 12½¢ to 17½¢ and a few years from now SCM could look alot better than it does at this depressed level.

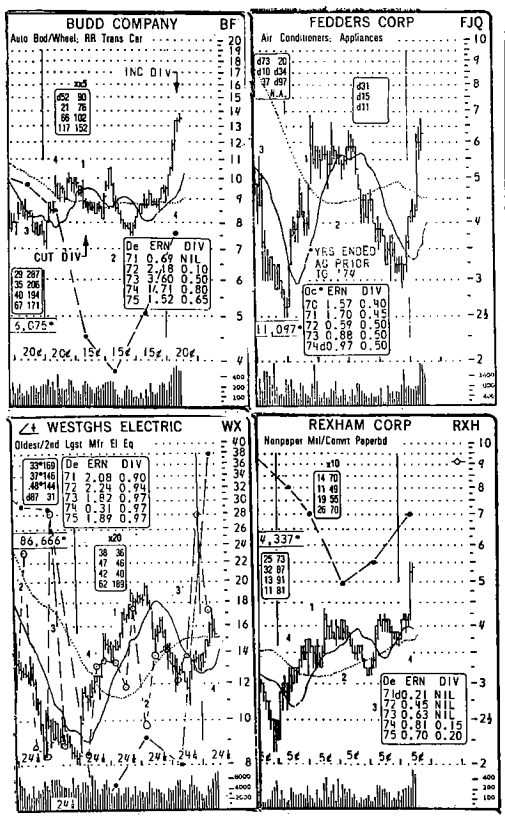
Of interest are major February upside breakouts in RS in the following issues: General Electric, Meredith, Clorox, Fruehauf, Dr. Pepper, Robertshaw, and Int. Tel & Tel (the last should be of great interest to those who purchased the ITT convertibles last year).

The chart at right shows the action (monthly) in SCM from 1964 to date. The stock has now moved out of the strong base which formed in the 8 to 15 area, and in so doing SCM has reversed its long declining trendline. Note that the 8-year crash in this stock has assumed the form of an A-B-C Elliott bear market. It is a bear market which I believe is completed. (SCM chart courtesy of Sec. Research, 208 Newbury St., Boston, Mass 02116. Smaller weekly charts courtesy of Quote, PO Box 213, Wichita, KA 67201).



GOLD: What really happened to gold shares during the great gold bear market of 1974 to date? The clearest illustration I have seen is provided by the gold index published by Capital International Perspectives. The CIP Gold Mines Index is composed of 28 major gold mines operating in Canada, South Africa and the US (the US's only entry is Homestake).

The accompanying chart shows that the CIP Gold Mines Index dropped 60.1% from its 1974 high to its 1976 low. Furthermore, the relative strength line shows that the Gold Mines Index has consistently performed worse than gold bullion during this period.



Stock	Bull Market High	1974 Bear Market Low	% of Decline to 1974 Low	Current Price	% of Retracement of Bear Losses so far
Addressograph	92	3	96%	12	10%
Allis Chalmers	44	6	86	15	23
Alberto-Culver	46	4½	90	7½	7
Amer.Medic.Int.	50	2 3/4	94	9	13
Avco	60	2	96	8	10
Bell & Howell	95	9	90	21	14
McGraw Hill	56	5½	88	16	20
SCM	92	8	91	16	10
City Investing	39	4	89	9 3/4	17
Cluett Peabody	37	2½	92	10	20
Clorox	53	5½	96	14	20
Fedders	50	2½	94	6	7
Filtrol	55	6	89	10	10
Handelman	46	3	93	6 3/4	9
High Voltage Eng.	44	3	93	6	7
Lear Siegler	30	3½	86	9	20
Litton	92	3	96	9	7
MacMillan	37	3	91	6¾	9
Marathon Mfg.	50	5	90	10	9
Meredith Corp.	60	7	88	15	15
Milton Bradley	48	4	91	14½	24
Monroe Equip.	46	6	87	9	8
Pan Amer.World Air.	38	1 3/4	94	6	12
PSA	50	3½	90	7	8
Sanders Assoc.	74	1 3/4	97	9	10
Saxon Indust.	42	2	95	6	10
Talley	62	5	92	9	7
TWA	100	5	95	9½	5
Un't Fin. of Cal.	32	4	87	8	14
U.S. Leasing	36	5½	83	10	15

This list above includes a sampling of stocks which collapsed during the bear market. The last column shows what percentage of the bear market declines have been recouped so far in 1975-76. My conclusion is that there is "a lot of room on the upside" for many of these issues. This list contains stocks that I like for good bull market recoveries, but many are obviously very speculative (at their old highs, of course, they were considered "sound investments").

I have labeled the Gold chart according to my interpretation of the Elliott Wave Principle. Most primary bear markets assume the form of a three-wave downmove, an A wave down, an upward correction to B and a final usually crushing wave to the bottom of the bear market at C. These three major waves can often be subdivided into a 5-3-5 pattern, and I have shown this on the chart.

I show major wave A breaking down into five sub-waves. Then I show a very weak correction to B, weak because point c did not advance above point a. Next I show the smashing collapse to the recent lows at C, and it is interesting to note that this collapse has taken (so far) the form of five sub-waves. The current problem is that we do not know whether the final sub-wave 5 is completed.

At any rate, it does appear to me that the bear market in gold shares could be nearing an end, at least based on Elliott. This does not mean that we should all rush in to load up on gold shares. Bear markets do not end in a day, to immediately give way to roaring bull market advances. However, based on this chart I do not see the harm in assuming very careful positions in Homestake, as suggested in recent reports. For those willing to assume the political risks of investing in S. African shares, I would also recommend careful pilot positions in Amgold (ADR's).

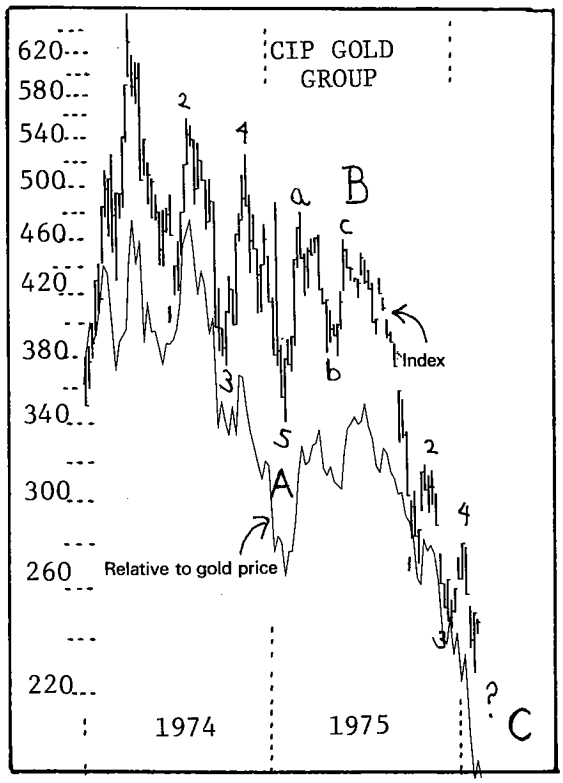
It is well to remember that a bear market bottom tends to discount the worst that can be seen ahead. Personally, I am not enamored with the whole S. African political situation. But my technical studies suggest that the gold shares may have collapsed to the point where all the risks are substantially discounted in the price structure. When that happens (as it did in the US stock market in December, 1974), there is nowhere to go but up.

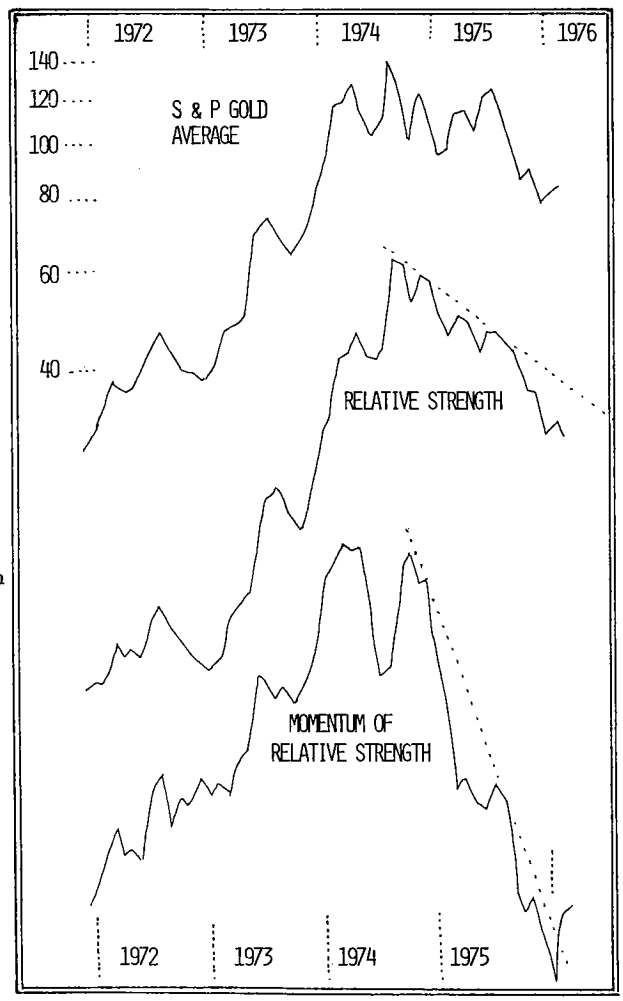
I want to stress, however, that even though the bear market in gold shares may be over or near over, there is always the danger in this kind of situation that you can buy the stocks and sit for months to even years before a real move arrives.

As I have said so many times before (and here I go again), one way you can minimize this danger is by utilizing (1) momentum studies and (2) relative strength studies. Momentum has to do with a stock's rate of change. For instance, a given stock can be slowly creeping higher, and that's fine. It means that its momentum is plus. But I also like the same stock to be rising faster than the market and that means positive momentum and positive relative strength (RS).

The Barron's Gold Group is now showing plus momentum on its 13-week momentum line but 34-week momentum has not yet turned up. This is hopeful, but it means that the story is not yet really bullish. The second problem for gold buffs is illustrated in the RS chart below. Here we see the S&P Gold Average, its RS line (Gold group compared with the S&P 500), and finally the six months rate of change in gold RS at the bottom of the chart. Interpreatation— gold is not yet acting better than the market, but, as seen in the RS momentum line, gold RS could be "getting ready" to turn up. My feeling is, let's wait for a trend reversal in Gold RS before getting excited. Until that happens, we can guess, we can figure, we can even buy a little Homestake and Amgold in anticipation. But as of now, my work does not prove that a bull market in gold shares has started - - yet.

The final point I want to make is this. Even though the final sub-leg 5 (on the chart) may not be complete, I no longer advocate selling gold shares as far as those of you who still hold them are concerned. In other words, if you have gold shares now, if you never sold your gold shares (despite all my advice), then from here on you might as well sit tight. I think we are close enough to a final low to say this.





LATE NOTE: My RS studies show that the trend is now definitely toward improving RS in the capital goods stocks and weakening RS in consumer goods stocks. Therefore, aim new money towards capital goods. Coming "surprise" is going to be real strength in building and real estate stocks. RS is building in these groups.

Next Mailing: February 27